NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: HB 1734 (5th Edition)

SHORT TITLE: NC Economic Stimulus and Job Creation Act

FISCAL IMPACT ($MIL.)

Yes (X) **No** ( ) **No Estimate Available** ( )

	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06	FY 2006-07
GENERAL FUND REVENUES:					
Bill Lee Act Changes:					
Machinery/Equip. Credit	-	3.64	7.27	10.91	14.54
Wage Test for Tiers 1 & 2	-	(0.08)	(0.16)	(0.24)	(0.32)
Worker Training Wage Test	-	(0.11)	(0.11)	(.11)	(.11)
Job Development Grants	"See Assumptions and Methodology"				
Film Industry Incentives	(0.03)	(0.10)	(0.10)	(0.10)	(0.10)
Corporate Rate Changes		(4.3)	(17.10)	(18.10)	(19.20)
Travel & Tourism	-	(20.00)	(40.00)	(60.00)	(60.00)
TOTAL	(0.03)	(20.95)	(50.20)	(67.64)	(65.19)
EXPENDITURES:					
Travel & Tourism Grant Com.	* See Assumptions and Methodology *				
Department of Revenue	* See Assumptions and Methodology *				
Special Obligation Bonds					
Debt Service	-		6.68	25.22	22.89
Operating Expenditures	-	-	-	.86	.79

PRINCIPAL DEPARTMENTS AFFECTED: Department of Revenue, Department of Commerce, Office of State Budget and Management.

BILL SUMMARY:

TITLE I: BUSINESS AND ECONOMIC INCENTIVES

PART 1A: BILL LEE ACT CHANGES

Issue Background: The Bill Lee Act is the package of state tax incentives that was first adopted in 1996 and has been modified in each subsequent year. The incentives are primarily in the form of tax credits for investment in machinery and equipment, job creation, worker training, and research/development. The credits apply to activities undertaken by specifically named industrial classifications. For many of the credits, the counties of the State are divided into five economic distress tiers based on the unemployment rate, per capita income, and population growth. In general, the lower the tier of a county, the more favorable the incentive.

Bill Summary. Restructure Machinery and Equipment Credits. Under current law, the targeted statewide investment tax credit is equal to 7% of eligible investment in machinery and equipment. The credit is taken over seven years and applies to the investment that exceeds a certain threshold. The threshold amount varies by tier as follows:

Tier	Threshold	Credit
1	0	7%
2	100,000	7%
3	200,000	7%
4	500,000	7%
5	1,000,000	7%

The threshold is used first to determine eligibility. In addition, the credit is based on the amount of the investment in machinery and equipment that exceeds the threshold amount. The bill restructures the credit rate and threshold by increasing the minimum investment threshold in Tiers 4 and 5 and lowers the credit percentage in Tiers 3 through 5. The new credit schedule would be as follows:

Tier	Threshold	Credit
1	0	7%
2	100,000	7%
3	200,000	6%
4	1,000,000	5%
5	2,000,000	4%

The change is effective for business activities that occur on or after January 1, 2003, but not for those activities occurring on or after that date that are subject to a letter of commitment signed before the date.

Worker Training Credit Wage Test. In order to be eligible for Lee Act credits, taxpayers must meet certain wage tests. These tests are based on the average wage of the company's jobs,

calculated based on all jobs at an establishment. The bill eliminates the wage test for the worker training credit. The change is effective for tax years beginning on or after January 1, 2003.

Eliminate Wage Test for Tiers 1 and 2. Under current law, taxpayers applying for the Lee Act credits must meet 100% of the wage standard in Tier 1 and exceed 110% of the wage standard in the remaining tiers. The bill eliminates the wage standard for Tiers 1 and 2. The change is effective for tax years beginning on or after January 1, 2003.

Wage Test Timing. Changes wage test from a calendar year calculation to taxpayer's fiscal year.

Development Zone Technical Change. Enhanced Lee Act credits are allowed for projects in development zones (high poverty areas). The bill indicates that a parcel of property partially located in a development zone is considered entirely within the zone if all of the following conditions are met: (1) at least 50% of the parcel is located within the zone; (2) the parcel was in existence and under common ownership prior to the most recent population census; and (3) the parcel is a portion of land made up of one or more tracts or tax parcels of land that is surrounded by a continuous perimeter boundary. This change becomes effective July 1, 2002.

PART 1B: JOB DEVELOPMENT INVESTMENT GRANT PROGRAM

Bill Summary: Establishes the Job Development Investment Grant Program to be administered by the Economic Investment Committee. Under the program, the Committee may enter into agreements with businesses to provide grants in the form of withholding tax payment rebates. Before entering into an agreement, the Committee must find that all the following conditions are met:

(1) The project proposed by the business will create, during the term of the agreement, a net increase in employment in this State.
(2) The project will benefit the people of the state by increasing employment opportunities and by strengthening the state's economy.
(3) The project is consistent with economic development goals for the State and for the area where it will be located.
(4) A grant is necessary for the completion of the project in North Carolina.
(5) The total benefits of the project to the State outweigh its costs and render the grant appropriate for the project.

The number of agreements the Committee may enter into during a state fiscal year is limited to 15. In addition, there is a $10 million limit on the total annual grants entered into during a single fiscal year. The amount of a grant attributable to any specific position in a year is $6,500. Finally, the program expires on January 1, 2005.

A business may apply to the Committee for a grant for any project that creates the minimum number of eligible positions as set out in the table below. If the project will be located in more than one enterprise tier area, the location with the highest enterprise tier area designation determines the minimum number of eligible positions that must be created.

Enterprise Tier Area	Number of Eligible Positions
Tier One	10
Tier Two	10
Tier Three	10
Tier Four	20
Tier Five	20

A project that consists solely of retail facilities or a professional or semiprofessional sports team or club is not eligible for a grant. If a project consists of both retail facilities and non-retail facilities, only the portion of the project consisting of non-retail facilities is eligible for a grant, and only the withholdings from employees in eligible positions that are employed exclusively in the portion of the project that represents non-retail facilities may be used to determine the amount of the grant. If a warehouse facility is part of a retail facility and supplies only that retail facility, the warehouse facility is not eligible for a grant. Catalog distribution centers are not considered retail facilities.

The grants may not be used as venture capital funds, business incubator funds, business start-up funds, or to otherwise fund the initial capitalization of a business.

Just like the Bill Lee Act, a business must provide health insurance for all of the full-time employees of the project for which the grant is made. In addition, the average wage for all jobs at the location with respect to which the grant is sought must meet the Lee Act wage standard. Finally, the grants may not be provided to taxpayers who have an overdue tax debt or who have had an OSHA citation that has become a final order during preceding three years.

The Economic Investment Committee will consist of the following members:

(1) The Secretary of Commerce.
(2) The Secretary of Revenue.
(3) The Director of the Office of State Budget and Management
(4) One member appointed by General Assembly upon recommendation of Speaker of House.
(5) One member appointed by General Assembly upon recommendation of President Pro Tempore of Senate.

The members of the Committee appointed by the General Assembly may not be members of the General Assembly.

The Committee may act only upon a decision of three (3) of its five (5) members.

A business shall apply, under oath, to the Committee for a grant on a form prescribed by the Committee that includes at least all the following:

(1) The name of the business, the proposed location of the project, and the type of activity in which the business will engage at the project site or sites.

(2) The names and addresses of the principals or management of the business, the nature of the business, and the form of business organization under which it is operated.
(3) The most recent audited financial statements of the business and any other financial information the Committee considers necessary.
(4) The number of eligible positions proposed to be created during the base years and thereafter, and the salaries for these positions.
(5) An estimate of the total withholdings.
(6) Information concerning other states being considered for the project and the nature of any benefits the company would enjoy as a result of locating in those states.
(7) Certification that the business will provide health insurance to all full-time employees of the project.
(8) Information concerning any other state or local government incentives for which the business is applying or that it has an expectation of receiving.
(9) Any other information necessary for the Committee to evaluate the application.

A business may apply, in one consolidated application in a form and manner determined by the Committee, for a grant on its own behalf as a business and for grants on behalf of the related members of the business who may qualify.

The Committee will consider a application by a business for grants on behalf of its related members only if the related members for whom the application is submitted have assigned to the business any claim of right the related members may have under this program to apply for grants individually during the term of the agreement and have agreed to cooperate with the business in providing to the Committee all the information required for the initial application and the agreement, and any other information the Committee may require. The applicant business is responsible for providing to the Committee all the information required.

If a business applies for a grant on behalf of its related members, the related members included in the application may be permitted to meet the qualifications for a grant collectively by participating in a project that meets the requirements of the program. The amount of a grant may be calculated as if the related members were all collectively one business entity. Any conditions for a grant, other than the number of eligible positions created, apply to each related member who is listed in the application as participating in the project. The grants awarded shall be paid to the applicant business. A grant received by a business may be apportioned to the related members in a manner determined by the business. In order for an agreement to be executed, each related member included in the application must sign the agreement and agree to abide by its terms.

When filing an application under this section the business must pay the Committee a fee of $5,000. The fee is due at the time the application is filed. The executive branch members of the Committee shall determine the allocation of the fee imposed by this section among the agencies responsible for evaluating the application. The proceeds of the fee are receipts of the agency to which they are credited.

The bill establishes extensive reporting requirements for the Committee.

The Committee is required to conduct a study to determine the minimum funding level required to implement the program successfully and to report the results of this study no later than March 1 of each year.

The amount of the grant awarded in each case shall be a percentage of the withholdings of eligible positions. The percentage shall be no less than 10% and no more than 75% of the withholdings of the eligible positions for a period of years. The percentage used to determine the amount of the grant shall be based on criteria developed by the Committee after considering the following:

(1) The number of eligible positions to be created.
(2) The expected duration of those positions.
(3) The type of contribution the business can make to the long-term growth of the State's economy.
(4) The amount of other financial assistance the business will receive from the State for the project.
(5) The total dollar investment the business is making in the project.
(6) Whether the project uses existing infrastructure and resources in the community
(7) Whether the project is located in a development zone
(8) The number of eligible positions that would be filled by residents of a development zone.
(9) The extent to which the project will mitigate unemployment in the state and the locality.

The term of the grant shall not exceed 12 years starting with the first year a grant is made.

The grant percentage may be based only on eligible positions created during the base years (first two years of program) unless the Committee makes an explicit determination that the grant shall also be based on additional eligible positions created during the remainder of the term of the grant.

The percentage established in the agreement shall be reduced by 25% for any eligible position that is located in an enterprise tier four or five area.

A business that is receiving any other grant by operation of State law may not receive grant monies under this program if the total state grants exceed 75% of the withholdings of the business, unless the Committee makes an explicit finding that the additional grant is necessary to secure the project. The minimum grant is 10%.

Each community economic development agreement shall include the following:

(1) A detailed description of the proposed project that will result in job creation and the number of new employees to be hired in the base years and later years.
(2) The term of the grant and the criteria used to determine the first year for which the grant may be claimed.
(3) The number of eligible positions that are subjects of the grant and a description of those positions and the location of those positions.
(4) The amount of the grant based on a percentage of withholdings.
(5) A method for determining the number of new employees hired during a grant year.
(6) A method for the business to report annually to the Committee the number of eligible positions for which the grant is to be made.
(7) A requirement that the business report to the Committee annually the aggregate amount of withholdings during the grant year.
(8) A provision permitting an audit of the payroll records of the business by the Committee from time to time as the Committee considers necessary.
(9) A provision that permits the Committee to amend an agreement pursuant to certain guidelines.
(10) A provision that requires the business to maintain operations at the project location or another location approved by the Committee for at least 150% of the term of the grant and a provision to permit the Committee to recapture all or part of the grant at its discretion if the business does not remain at the site for the required term.
(11) A provision that requires the business to maintain employment levels in this State at the level of the year immediately preceding the base years.
(12) A provision establishing the conditions under which the grant agreement may be terminated and grant funds recaptured by the Committee.
(13) A provision stating that unless the agreement is amended or terminated the agreement is binding and constitutes a pledge and a continuing obligation of the state.
(14) A provision setting out any allowed variation in terms of the agreement that will not subject the business the business to amendment or termination of the agreement.
(15) A provision that prohibits the business from manipulating or attempting to manipulate employee withholdings with the purpose of increasing the amount of the grant and that requires the Committee to terminate the agreement and take action to recapture grant funds if the Committee finds that the business has manipulated or attempted to manipulate withholdings with the purpose of increasing the amount of the grant.
(16) A provision requiring that the business engage in fair employment practices as required by State and federal law and that the business endeavor to use small contractors, minority contractors, physically handicapped contractors, and women contractors whenever practicable in the conduct of its business.
(17) A provision requiring that the business give priority consideration to hiring North Carolina residents.
(18) A provision encouraging the business to use the N.C. State Ports.

(19) A provision stating that the state is not obligated to make a grant payment until the state has received withholding payments from the business that exceed the grant payments.

(20) A provision describing the manner in which the amount of the grant will be measured to ensure compliance with the grant caps.

(21) A provision stating that any recapture of a grant and any amendment to an agreement reducing the amount of the grant or the term of the agreement must, at a minimum, be proportional to the failure to comply measured relative to the condition or criterion with respect to which the failure occurred.

(22) A provision stating that nay disputes over interpretation of the agreement shall be submitted to binding arbitration.

(23) A provision stating that the amount of a grant associated with any specific eligible position may not exceed six thousand five hundred dollars ($6,500) in any year.

Proposed agreements must be personally signed by the Attorney General.

No later than February 1 of each year, for the preceding grant year, every business that is awarded a grant shall submit to the Committee a copy of its State and federal tax returns showing business and nonbusiness income and a report showing withholdings as a condition of its continuation in the grant program. In addition, the business shall submit to the Committee an annual payroll report showing the eligible positions that are created during the base years and the new eligible positions created during each subsequent year of the grant. When making a submission under this section the business must pay the Committee a fee of $1,500. The fee is due at the time the submission is made. The executive branch members of the Committee shall determine the allocation of the fee imposed by this section among the agencies responsible for evaluating the submission. The proceeds of the fee are receipts of the agency to which they are credited.

The Committee may require any information that it considers necessary to effectuate the provisions of this program. The Committee may audit any business receiving a grant at any time.

If the business receiving a grant fails to meet or comply with any condition or requirement set forth in an agreement or with criteria developed by the Committee, the Committee shall amend the agreement to reduce the amount of the grant or the term of the agreement and may terminate the agreement. The reduction in the amount or the term must, at a minimum, be proportioned to the failure to comply measured relative to the condition or criterion with respect to which the failure occurred.

If a business fails to maintain employment at the levels stipulated in the agreement or otherwise fails to comply with any condition of the agreement in any year, the Committee must terminate the agreement.

If the Committee finds that the business has manipulated employ withholdings in order to increase the grant amount, the Committee shall immediately terminate the agreement and take action to recapture any grant funds disbursed in any year in which the violation occurred.

Disputes involving interpretation of the agreement must be submitted to binding arbitration.

A qualifying business may receive an annual disbursement of a grant only after the Committee has certified to the State Controller that the business has met the terms and conditions of the agreement. No amount shall be disbursed to a business as a grant under this program in any year until the Secretary of Revenue has certified to the Committee the amount of withholdings received in that year by the Department of Revenue from the business. A qualifying business that has met the terms of the agreement shall make an annual certification of this to the Committee. The Committee shall verify this information and certify to the State Controller that the terms of the agreement have been met. The Committee shall further certify to the State Controller the amount of a grant for which the business is eligible under the agreement and the amount of a grant for which the business would be eligible under the agreement without regard to the 25% grant reduction in Tiers 4 and 5. The State Controller shall remit a check to the business in the amount of the certified grant amount within 90 days of receiving the certification of the Committee.

At the time the State Controller remits a check to a business, the State Controller shall transfer to the Utility Account of the Industrial Development Fund an amount equal to the amount certified by the Committee as the difference between the amount of the grant and the amount of the grant for which the business would be eligible without regard to the 25% reduction for Tiers 4 and 5.

In developing criteria for the awarding of grants and for determining the percentage upon which the amount of a grant is based, the Economic Investment Committee shall consider criteria that address the following:

(1) Economic impact of the project.
   a. Impact on gross regional product and gross State product.
   b. Costs and benefits of the project to the State, including the expected return on investment made in the project by the State.
   c. Number of direct jobs that will be created by the project, the wages of those jobs, and the total payroll for the project.
   d. Number of induced short-term, project-related jobs expected to be generated by the project as well as the number of long-term permanent jobs expected to be generated indirectly in the economy as a result of the project.
   e. Dollar value of the investment, including the size of the investment in real versus personal property and expected depreciation rates.
   f. Economic circumstances of the county and region, including the extent to which the project will serve to mitigate unemployment.
   g. The expected time frame during which the project is expected to pay back in State tax revenues the amount of any grants to be paid out.
   h. The economic demands the project is expected to place upon the community or communities in which it will locate.
   i. The number of eligible positions that would be filled by residents of development zones.

(2) Strategic importance of the project to the State, region, or locality.

a. The extent to which the project builds or enhances an industrial cluster.

b. The extent to which the project falls within a classification of business and industry that the Department of Commerce regards as a target for growth and expansion in the State.

c. The ability of the project to attract follow-on investment in the State by suppliers and vendors.

d. The extent to which the project serves to maintain and grow jobs in the State in a business undergoing an internal restructuring or rationalization process.

e. The extent to which the project can be expected to contribute significantly to and support the local community.

(3) Quality of jobs.

a. The wage level and status of the jobs to be created.

b. The quality and value of benefits offered by the company.

c. The potential for employee advancement.

d. The extent of training programs offered by the company.

e. The sustainability of the jobs in the future.

f. The workplace safety record of the company.

(4) Quality of the industry and the project.

a. The nature of the project and the projects' relationship to the larger business of the company.

b. The nature of the industrial classification of the project and the nature of the business of the company undertaking it.

c. The long-term prospects for growth at the project site or sites.

d. The long-term prospects for growth of the company and the industry within the United States.

e. The financial stability of the company associated with the project.

(5) Environmental impact of the project.

a. The nature of the business to be conducted.

b. The ability of the project to satisfy State, federal, and local environmental law and regulations.

(6) Geographical dispersion among regions of state and between rural and urban areas.

The bill also makes two changes to the Industrial Development Fund (IDF) and to the Utility Account, which is part of that Fund. The IDF provides assistance to local governments for improvements to infrastructure to enable the locality to attract new businesses. Usually, this assistance is provided to make general improvements, such as improvements to or development of industrial parks, and is not tied to luring a specific project.

The first change is to expand the purposes for which funds in both the Fund and the Account may be used to allow expenditures for telecommunications and high-speed broadband lines and

equipment. In addition, the bill would expand the focus of the Utility Account to allow funds to be used to assist local governments in enterprise Tier 3 as well as Tiers 1 and 2 (current law).

The provisions dealing with the job development investment grant are effective when the bill becomes law.

PART IC: FILM INCENTIVES

Under current law, film production companies that engage in production activities in North Carolina may apply for a grant from the Department of Commerce. This grant cannot exceed fifteen percent (15%) of the amount that production company spends for goods and services in the state during a calendar year, or $200,000 per production. The recently passed budget bill deposited $500,000 in this account.

The bill tightens the requirements to receive the grant by limiting it to production companies that expend at least $1,000,000 in the state. It also gives these production companies the opportunity to receive an annual refund of the State sales tax they pay on lodging. The refund only applies to rooms rented for employees who stay more than 30 days, but less than 90 days.

A request for a refund must be made within six months after the end of the state's fiscal year. The refund provision applies to taxes paid on or after January 1, 2003.

PART 1D: CORPORATE INCOME TAX RATE CHANGE

Under current law all corporations pay tax at a rate of 6.9% of all taxable income. The bill lowers the tax rate on the net taxable income of up to $30,000 as follows:

Net Taxable Income*	Tax Rate
1-3,000	1%
3,001-6,000	2
6,001-9,000	3
9,001-12,000	4
12,001-15,000	5
15,001-30,000	6
30,001 & Over	6.9%

*Income remaining after deduction of expenses ("taxable profits").

The rate change is effective for tax years beginning on or after January 1, 2004.

PART IE: TRAVEL AND TOURISM INCENTIVES

This portion of the bill creates the Travel and Tourism Capital Incentive Grant program to be administered by the Travel and Tourism Grant Committee. The program offers grants to counties and municipalities who own "qualifying projects" that meet the following criteria: 1) the project is financed and owned, in whole or at least in 50% partnership (25% in tiers 1, 2, and 3) by the unit of local government in which it is located; 2) the project will target 35% or

more of its visitors from at least 50 miles away or out of state (25% in tiers 1, 2 and 3); 3) the project has a business plan that indicates that project will be profitable; 4) the applicant provides tax impact projections; 5) the project will have a significant and positive impact on the community; 6) the project will be open at least 100 days per year; 7) the project will generate at least ten new jobs in the local area; 8) the projects will meet a minimum cost criteria based on the North Carolina enterprise tier in which it is located; 9) the governing body of the local government passes a resolution stating the need for, positive economic impact of, and the enhanced travel and tourism opportunities created by the project; and 10) the applicant demonstrates that the project will not duplicate services and will draw new visitors to the area. Grant funds can be used to fund new projects or the renovation and expansion of existing facilities. The grant amount is determined by multiplying the total amount of sales taxes and entertainment taxes collected by or within the qualified program and the net privilege taxes paid by the qualifying project by an enterprise tier based percentage, with maximum percentages outlined in the bill (40% tier 1 and 2, 30% tier 3 and 4, and 25% for tier 5). These same percentages apply to the maximum amounts of the total project cost that can be funded through this grant program. Projects must meet minimum cost requires, which differ by tier, to be eligible. The Travel and Tourism Grant Committee is charged with determining if all project criteria are met and the percentages used to calculate the grant amount. Grant funds can only be used for capital costs, including debt service. To receive a grant disbursement, the project owner must provide the Department of Revenue with periodic, verified accounting of the tax collections. Annual disbursements based on this information must be made by the Department of Revenue by October 1 of each year and should reflect tax collections from that project for the previous fiscal year. The Department is only required to distribute funds based on data provided by the owner. If appropriate data is not provided to justify a complete payment, a partial payment can be made to reflect the information provided. Applicants must fund a feasibility study coordinated and directed by the Travel and Tourism Grant Committee and pay a $5,000 application fee. The funds to pay for the grants and the associated departmental costs are drawn from State sales and use tax revenues. The grant application period for the bill sunsets July 1, 2005, although payments for grants authorized before that date will continue to be made up to ten years after the initial award. Only fifteen (15) grants can be awarded per year. Annual awards are limited to $20 million.

The Travel and Tourism Grant Program becomes effective January 1, 2003.

TITLE II: SPECIAL OBLIGATION SETTLEMENT BONDS

Authorizes the State to issue special obligation bonds, which would be secured solely by, and payable solely from, a portion of the expected receipts from the Master Settlement Agreement (MSA). Currently, the receipts from the MSA are divided as follows: 50% to The Golden L.E.A.F., Inc., 25% to the Tobacco Trust Fund, and 25% to the Health and Wellness Trust Fund. The special obligation bonds would be secured by up to $25 million a year that would otherwise go to the Tobacco Trust Fund and the Health and Wellness Trust Fund. The precise amount pledged would be specified in the bond documents. These annual amounts would be intercepted in the Settlement Reserve Fund and used to pay the debt service on the bonds until the bonds are retired.

A maximum of $175 million in special obligation bonds could be issued, up to $130 million for construction of a new cancer rehabilitation and treatment center to be located at UNC. Hospitals

and up to $45 million for construction of a new biopharmaceutical/bioprocess manufacturing training center to be located at North Carolina State University.

Special obligation bonds are not general obligation bonds and thus are not required to be approved by the voters. Neither the faith and credit nor the taxing power of the State would secure them and a statement to this effect would appear on the face of the bonds. Property could not be pledged to secure the bonds. The sole security and source of repayment would be up to $25 million a year of that part of the receipts from the Master Settlement Receipts otherwise designated to be divided evenly between the Tobacco Trust Fund and the Health and Wellness Trust Fund. The part of the settlement receipts designated for The Golden L.E.A.F., Inc. is not affected by this bill. Although the part of the annual receipts designated for the two trust funds is currently estimated at about $70 to $80 million a year, if it were to fall to a lower level, the pledged amount for repaying the bonds each year would have priority over the funds going to the two trust funds.

If the Master Settlement Agreement receipts designated to the two trust funds fell to a point where they were insufficient to pay debt service on the bonds, the bill provides that no other source of funds may be used to pay the bonds. The State would not be obligated to pay the debt from other sources and a default not within the State's control would not be expected to affect its credit rating. The General Assembly could chose, however, to amend the legislation at that time to authorize the use of other State revenues to pay the debt service. Such a provision is not in the bill at this point because it could make the proposed bonds a liability of the State, which could affect the State's existing bond rating, rather than a liability solely of the pledged settlement receipts.

ASSUMPTIONS AND METHODOLOGY:

Bill Lee Act Changes: The fiscal impact estimates for the proposals modifying the Bill Lee Act are based on a sampling of 1999 tax returns filed by businesses reporting or claiming Lee Act credits. The sampling was carried out by the Department of Commerce, based on a universe of 566 firms claiming credits, and was based on scientific methodology. The actual sample size represented 39% of the firms. Since some firms in the sample had facilities at two or more sites, there were a total of 260 locations included in the sample.

Job Development Investment Grant Program: This initiative represents a significant change from the structure of the Bill Lee Act incentives. Eligibility language in the bill leaves the determination to the Economic Investment Committee. This committee will have broad discretion to negotiate the terms of an agreement, including the amount of the grant and the number of years for which the grant is provided. This makes it impossible to determine the exact dollar cost of the grant program. The program is limited to 15 projects per year and contains a $10 million cap per year.

Film Industry Incentives: The first change, tightening the eligibility requirements, is not expected to carry a fiscal impact. Under current law, the Department of Commerce has a great deal of discretion in determining grant awards. It is unlikely Department officials would award a grant to a production company that does not met the new criteria. Therefore, no fiscal impact is anticipated.

The sales tax refund is expected to have an impact on the General Fund. According to a 1999 memo from the Department of Commerce, “most lower-budget feature films, television Movies-of-the-Week, commercials and music television shoots stay on location less than 30 days, and even long-running television series, such as “Matlock” or “Dawson’s Creek”, which may film here for nine months or more of a given year, usually employ resident crews and the occasional executive who would occupy an apartment or condo long-term.” Given this, DOC continues, “the rebate on hotel room occupancy after 30 days would most likely only apply to films with budgets of $25 million and above. The film division estimates that a rebate to this type of production company would be approximately $10,000. Recent conversations with representatives of this office indicate that this estimate is still reasonable. They also indicate that in 1993, the most active year of the film industry in the state, there were six (6) production companies that would have qualified for the refund. These officials also indicate that it is unlikely the state will see more activity than this in future years, assuming there is no significant change in the film industry. Because of this uncertainty, a more conservative maximum estimate of $100,000 per year is used for the out years of the fiscal note. Because of the January 1, 2003 effective date, ½ of the current maximum year potential cost of $60,000 is used as the 2002-03 cost.

Corporate Income Tax Rate Change: The latest available date on corporate income tax liability by size of taxpayer is for the 1994 tax year. In addition, we have data for the 1990 tax year. The 1990 and 1994 state data, combined with 1994-99 distribution data for federal corporate returns, provides evidence of how liabilities in the different size groupings grow over time. In addition, the data can be correlated with national measures of pre-tax corporate profits to gauge the factors affecting the growth in the number of taxable returns and changes in the average taxable income for each taxable income class.

Since there is no current annual liability distribution data available, a simulated distribution was developed. The starting point was a comparison of the Fiscal Research Division estimate of "collections based" annual liability (using monthly corporate income tax receipts matched to appropriate tax year) for 1990 and 1994 with the tabulated actual liability. This comparison provided a mechanism that could be used to simulate a 2004 tax year liability distribution by size based on an estimate of the 2004 tax year "collections-based" liability. The latter number was developed using a correlation between U.S. pretax profits and the North Carolina amount estimated by dividing "collections based liability" by the 6.9% tax rate. The U.S. pre-tax profits estimate is from the September 2002 forecast of *Economy.com.*

The conclusions of the analysis using 1990 and 1994 data are supported by a recent Department of Revenue analysis, using 2000 tax year data from the Integrated Tax Analysis System (ITAS).

The analysis assumes that most of the calendar year tax change takes place through a reduction in final tax payments (due March 15) or refunds. The estimate assume that some taxpayers will adjust their April and June 2004 estimated tax payments for the 2004 tax year to take advantage of the tax relief. Normally, this reduction would be equal to about 45% of the annual amount. However, prior discussions with corporate tax personnel at the Department of Revenue indicate that many taxpayers choose to keep estimated payments at a pre-cut level and receive a refund the next Spring. For that reason this analysis uses a 25% adjustment.

Travel and Tourism Incentives: The bill effectively earmarks a proportion of state tax revenue drawn from a particular qualifying project and returns that funding to the institution to fund capital costs and debt service. The proportion returned varies by location and other factors. The bill would allow funding for fifteen projects a year, with a maximum of forty-five (45) grants awarded before the July 1, 2005 sunset. At present Fiscal Research is aware of several potential projects that have already reach the planning stages, primarily arenas, convention centers and athletic facilities, that could easily qualify for these grants, although local government officials indicate that many local units would likely be interested applying for these grants. Fiscal Research is also not aware of any other state that uses a similar funding mechanism, so no data is available from other states to suggest a fiscal cost. (Kentucky has a state sales tax incentive program for tourism development, which has funded seven (7) projects to date. However, because of substantial differences in the Kentucky plan and this bill, that state's experience cannot be used as a proxy for estimating purposes). Because there is no good data on the type, size and location of qualifying projects or potentially qualifying projects, the fiscal note assumes the committee awards the maximum annual amount of $20 million. Because the bill allows three grant cycle before the sunset, the maximum annual impact is reached in 2004-05 of $60 million ($20 million from each year of awards). Because all economic activity, in total, is considered in determining the state's baseline revenue projections, all grants awarded under this program would be shown as a loss of state revenue. However, none of that loss would appear in FY 2002-03, as the first payment would not be made for any project until October 2003.

EXPENDITURE IMPACT

Travel and Tourism Incentives: This portion of the bill has the potential to affect two areas of expenditures.

Travel and Tourism Grant Committee: The bill charges the Travel and Tourism Grant Committee (the Committee) with carrying out the following activities in order to administer the grant program:

1. Adopt rules for the administration of the program.

2. Coordinate and direct feasibility studies funded by the applicants. This coordination function includes selection by the Department of qualified, independent consultants and prescription of the scope of each study.

3. Analyze applications to ensure they contain all necessary information regarding the nature and cost of the proposed tourism project, the estimated revenues to be generated by the project, the estimated economic benefit to the community, and the purposes for which the applicant will use grant funds.

Each of these activities will involve a cost to the Committee. The bill allows the Committee itself to determine how the fee revenue and associated responsibilities will be distributed. Since the bill does not specify the financial structure of the Committee, how the Committee will operate, or how the Committee will utilize the $5,000 fee per application, it is not possible to estimate the fiscal impact on the Committee.

Department of Revenue: According to the Department of Revenue, the anticipated responsibilities from the enactment of the bill will not justify any positions being assigned to

handle the work and, therefore, no employee costs will be incurred. There will only be minimal costs for printing and mailings of forms and possibly some other minor administrative costs. The Department assumes there will be a small number of projects that will qualify, at least initially. Therefore, based on this assumption, taxes eligible for grants will not be generated until a project is completed and business performed in the project. The first fiscal year for which grants could be issued would most likely be FY 2003-2004. This should provide the department with ample time to get procedures in place.

TITLE II: SPECIAL OBLIGATION SETTLEMENT BONDS

The debt service requirements for the proposed bonds are based on a September 5, 2002 simulation of the Office of State Treasurer. The analysis assumed that the $45 million of biotech bonds would be issued on January 1, 2004 and the $130 million of cancer center bonds would be sold on January 1, 2005. The assumed average interest rate for both issuances is 7.0% and the longest maturity for the bonds is 15 years. The 7.0% interest rate compares to the 6.0% rate the Treasurer uses for projecting the debt service on March 2003 General Obligation Bonds. The rate is higher due to the lower level of security on the bonds.

The total interest costs on the $175 million maximum amount of bonds is $100.1 million. Thus, the total debt service requirement will be $275.1 million over a 15-year period. This maturity level is shorter than the typical 18-20 years for general obligation bonds due to the lower security of the repayment stream.

Data on the additional operating expenditures for the training center for the biopharmaceutical/bioprocess project is based on information submitted by the University System. We have no data on the costs for the regional centers. The funding for the budget requirements would normally come through General Fund appropriations.

The operating costs of the cancer center will be financed through hospital receipts.

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DATE: September 30, 2002

Signed Copy Located in the NCGA Principal Clerk's Offices